

**STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
PUBLIC UTILITIES COMMISSION**

NEW ENGLAND GAS COMPANY

SURREBUTAL TESTIMONY

OF

SHARON PARTRIDGE

October 11, 2002

1 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A. My name is Sharon Partridge and my business address is 100 Weybosset Street,
3 Providence, Rhode Island 02903.

4 **Q. WHAT IS YOUR POSITION AND RESPONSIBILITIES?**

5 A. I am a Vice President for the New England Gas Company (“NEGC” or the
6 “Company”). My responsibilities include regulatory affairs, gas supply and finance.

7 **Q. WHAT IS YOUR PROFESSIONAL AND EDUCATIONAL BACKGROUND?**

8 A. I have over 20 years experience in the gas utility industry in Rhode Island. Prior to
9 joining the Company, I was Vice President, Chief Financial Officer and Secretary of
10 Valley Resources, Inc. I have testified before the Rhode Island Public Utilities
11 Commission (the “Commission”) on a variety of rate matters, gas adjustment filings
12 and in several refund dockets. I graduated from Bryant College in 1978 with a
13 Bachelor of Science degree in Business Administration and earned an MBA from
14 Providence College in 1990.

15 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?**

16 A. The purpose of my testimony is to provide surrebuttal testimony in response to the
17 testimony of David J. Effron relating to the return on equity calculations under the

1 Energize Rhode Island Settlement Agreement, approved by the Commission in Docket
2 2581 ("ERI-2").

3 **Q. Has the Company calculated the return on equity for the twelve months ended**
4 **September 30, 2001 and June 30, 2002 in accordance with the Settlement**
5 **Agreement?**

6 A. Yes, the calculations were done in accordance with the Settlement Agreement and the
7 resultant average return on equity for the combined periods totaled 10.4%, which is
8 below the 10.7% authorized by the ERI-2 settlement agreement.

9 **Q. Mr. Effron makes several modifications to the Company's earned return on**
10 **equity calculation, do you agree with these adjustments?**

11 A. No, I do not agree with these adjustments. In particular, the adjustments made by Mr.
12 Effron to the federal tax rate and the interest rate are inappropriate.

13 **Q. Do you agree with Mr. Effron's adjustment to the federal income tax rate used in**
14 **calculating the Company's earnings in the two, 12-month reporting periods**
15 **under evaluation?**

16 A. No, I do not agree with Mr. Effron's adjustment to substitute the federal tax rate of
17 Providence Gas Company ("ProvGas") for the actual effective tax rate applicable to
18 the Company's earnings in the two, 12-month reporting periods under evaluation.
19 This adjustment is not consistent with the provisions of the Settlement Agreement,
20 which are expressly designed to enable the Company to "accurately report earnings"

1 for the two reporting periods (Settlement Agreement at Paragraph I.2). The
2 Settlement Agreement identifies certain components that the Company must use in
3 calculating earnings for those reporting periods, which do not include a specification
4 that the federal tax rate will be the rate experienced by ProvGas in prior reporting
5 periods.

6 In support of his contention that the ProvGas federal tax rate of 35% should be
7 applied, rather than the actual effective tax rate of 38% experienced by the Company
8 in the period in which these earnings occurred, Mr. Effron relies only on the statement
9 that “[ProvGas] used a federal tax rate of 35% in the earnings report that was filed
10 with the testimony that became the basis for ERI-2” (Testimony of D. Effron at 6,
11 ln.21-23). Mr. Effron’s conclusion that the ProvGas federal tax rate of 35% is
12 applicable to the earnings-sharing calculation is not appropriate for several reasons.

13 Mr. Effron does not cite the record evidence to which he is referring, and therefore,
14 the Company is unable to specifically address his analysis of that testimony.
15 However, the fact that ProvGas may have used the federal tax rate applicable to its
16 earnings to demonstrate the operation of the earnings-sharing calculation at the time
17 that the Commission was evaluating the ERI-2 settlement proposal is irrelevant. In
18 Docket 2581, the ERI-2 proposal was evaluated based on financial data for the period
19 ending June 30, 2000, which was the most recent financial data available for
20 demonstration purposes at that time (see e.g., Response to Data Request RIPUC 1-09).
21 Nowhere in the Settlement Agreement or in the Commission’s order approving the

1 Settlement Agreement does it state that the federal tax rate applicable to ProvGas
2 would continue to be applied to the Company in future reporting periods. Nor does
3 the inclusion of the ProvGas federal tax rate in any testimony, discovery or “sample”
4 calculations in Docket 2581 provide a basis for substituting that rate for the actual
5 effective tax rate applicable to the Company’s earnings in the reporting periods under
6 evaluation. The Settlement Agreement states that results of the earnings-sharing
7 calculation will be “adjusted to reflect established Commission ratemaking principles”
8 (Paragraph I.2), which means that the Company is allowed to recover the cost of
9 federal-income taxes. Unless otherwise noted in the Settlement Agreement, the intent
10 of the ERI-2 earnings-sharing calculation is to accurately identify the Company’s
11 earnings in the two periods under evaluation, and therefore, there is no basis for the
12 application of the ProvGas federal tax rate to the Company’s earnings, which are
13 actually subject to a higher effective tax rate.

14 Because Southern Union Company files a consolidated tax return for its local
15 distribution operations, the federal tax rate applicable to the Company’s earnings in
16 the two reporting periods is the rate paid by Southern Union. Attachment SP-1 is
17 summary calculation of the effective tax rate, which demonstrates the effective tax rate
18 is above the 35% computed by Mr. Effron.

19 **Q. Do you agree with Mr. Effron’s adjustment to the interest rate used by the**
20 **Company in calculating its earnings?**

1 A. No, I do not. The second adjustment Mr. Effron makes is to the interest rate used by
2 the Company in calculating the return on equity. Since no determination has been
3 made in a ratemaking proceeding since the merger as to the appropriate cost of debt,
4 Mr. Effron is proposing to rely on the weighted cost of debt (7.38%) suggested by the
5 Division's witness (Mr. Kahal) in Docket 3401, which was based on an analysis of a
6 proxy group. The "proxy group" approach to the NEGC capital structure and cost
7 rates was put forth by the Company in Docket No. 3401, in response to concerns
8 raised by settling parties in the merger case, relating to the appropriateness of using
9 the Southern Union capital structure and cost rates in setting rates for Rhode Island
10 customers. See Merger Settlement Agreement, at Paragraph II.C.3 (page 10),
11 approved in Docket No. D-00-02 and D-00-03 (the "Merger Settlement"). The terms
12 of the Merger Settlement required the Company to submit an alternative capital
13 structure and costs rates for a "comparable group of local gas distribution companies."
14 Id. In Docket 3401, the Company's witness on the proxy group capital structure and
15 cost of capital provided testimony indicating that the appropriate weighted cost of debt
16 should be 7.93%.

17 The testimony that Mr. Effron cites to, which was provided by the Division's witness,
18 Mr. Kahal, was strongly contested by the Company and the Commission made no
19 findings of fact with respect to the respective merits of his testimony, or as to the
20 appropriate cost rate that should result from the proxy group analysis. Accordingly,
21 there is no basis for the Commission to rely on Mr. Kahal's calculations in this
22 proceeding, or equally, to reject Mr. Dunn's testimony that the weighted cost of debt

1 for the Company based on his analysis of the proxy group should be 7.93%. Because
2 no determination on the appropriate cost of debt for the Company has been made, the
3 Company used the previously established weighted cost of debt for ProvGas, or
4 7.87%, which is the best estimate of the Company's cost of debt, absent a new
5 determination in the context of a ratemaking proceeding. Moreover, this weighted
6 cost of debt strikes an appropriate balance between the cost rates proposed in Docket
7 3401 .

8 **Q. Do you agree with Mr. Effron's adjustment to remove prepayments from rate**
9 **base in calculating the Company's earnings?**

10 A. No, I do not agree with Mr. Effron's adjustment to remove prepayments from rate
11 base. The Settlement Agreement states that results of the earnings-sharing calculation
12 will be "adjusted to reflect established Commission ratemaking principles" (Paragraph
13 I.2), which means that the Company is allowed to include prepayments in its
14 calculation of rate base. In support of his contention that prepayments should be
15 excluded, Mr. Effron cites only to the "quarterly reports filed pursuant to ERI-1" and
16 the "rate base determination in Docket No. 2286" (Testimony of Mr. Effron at 9,
17 ln.23-26). As an initial matter, the documentation associated with ERI-1 has no
18 bearing on the calculations required in accordance with ERI-2. The rate plan put in
19 place by the ERI-2 Settlement Agreement was supported by documentation and
20 financial analysis prepared by ProvGas and evaluated by the Division (and the
21 Commission) independent of the ERI-1 rate plan. Nowhere in the Settlement

1 Agreement or the Commission's order approving the ERI-2 Settlement Agreement
2 does it state that rate base would be calculated based on the provisions of the ERI-1
3 quarterly reports. In fact, as noted above, the ERI-2 Settlement Agreement
4 specifically sets out the requirements for earnings-sharing calculations for the
5 reporting periods under evaluation, including that the calculation would be
6 accomplished consistent with Commission ratemaking principles. Therefore, the fact
7 that prepayments may have been excluded (possibly inadvertently) from ERI-1
8 earnings calculations is irrelevant. It is well-established under Commission precedent,
9 as acknowledged by Mr. Effron in testimony provided to the Commission in Docket
10 3401 and other ratemaking proceedings, that prepayments are an appropriate rate base
11 item. Mr. Effron does not question that the prepayments are accurately calculated or
12 that these costs have been incurred by the Company. Accordingly, there is no basis
13 for the exclusion of prepayments from rate base in calculating the Company's earnings
14 in this proceeding.

15 **Q. Does Mr. Effron make other adjustments that are incorrect?**

16 A. Yes, he does. Mr. Effron removes \$72,000 from operations expenses for the 12-month
17 period ending June 30, 2002. Although the Company believes that the removal of
18 these expenses is subject to dispute, the more important issue is that Mr. Effron did not
19 remove these expenses from "actual incurred costs," but rather, effectively removed
20 these costs only from the calculation of the Operation and Maintenance ("O&M")
21 expense cap. The removal of these costs from the "actually incurred costs" would

1 have no impact on the earnings calculation for the period because the Company's
2 actual O&M expenses exceeded the cap set forth in the ERI-2 Settlement Agreement
3 by over \$1.3 million. Accordingly, the elimination of \$72,000 in costs referenced by
4 Mr. Effron has no effect on the calculation of earnings in this proceeding.

5 **Q. Mr. Effron states that "one of the areas still being investigated is the**
6 **administrative and general expenses." Do you have any comment on this**
7 **investigation?**

8 A. Yes, the ERI-2 Settlement Agreement states "there will be no adjustments to actual
9 results to recognize or annualize known and measurable changes." Therefore, the
10 impact of this investigation will not have any impact on the ROE calculation because
11 normalization adjustments are not allowed in the ERI-2 Settlement Agreement.

12 **Q. On page 12 of Mr. Effron's testimony he calculated an excess-income multiplier**
13 **of 1.75 years, do you agree with this calculation?**

14 A. There is no basis for this calculation because it is not established in either the ERI-2
15 Settlement Agreement or the Commission's order approving the ERI-2 Settlement
16 Agreement. The ERI-2 Settlement Agreement specifically states that the earnings
17 report will calculate the return on equity "using an average of the return on equity for
18 the 2 twelve-month reporting periods: October 1, 2000 - September 30, 2001; and
19 July 1, 2001 - June 30, 2002" (Settlement Agreement at Paragraph I.2). The ERI-2
20 Settlement Agreement further states that any earnings in excess of 10.7% (as

1 modified), excluding the Company's incentive portion of non-firm margins will be
2 credited to the Deferred Revenue Account (id.). Thus, the provisions of the ERI-2
3 Settlement Agreement establish a two-step process, whereby (1) the return on equity is
4 calculated for each of the two reporting periods and is then averaged together to
5 establish the allowed return; and (2) any return on equity above the average return of
6 10.7% is subject to the sharing mechanism. The ERI-2 Settlement Agreement does
7 not state that a third step will occur, which is a "gross-up" calculated by applying a
8 multiplier of 1.75 years. Accordingly, there is no basis for this adjustment.

9 **Q. Does this conclude your testimony?**

10 **A. Yes.**

Southern Union Company
Effective Federal Tax Rate Calculation
For the years ended June 30, 2002 and 2001
(in 000's)

	<u>2002</u>	<u>2001</u>
Taxable Income	\$ 34,731	\$ 96,683
Computed statutory tax expense	\$ 12,156	\$ 33,839
Changes in taxes resulting from:		
State income taxes	1,454	751
Amortization/write downs	3,793	5,277
IRS Audit	(1,570)	-
Investment Tax Credit Amortization	(644)	-
Other	(81)	133
Actual tax expense	\$ 15,108	\$ 40,000
Effective Tax Rate	43%	41%
Effective Tax Rate, excluding State Income Taxes	39%	41%
Effective Federal Tax Rate - Utility Operations	38%	38%